Tennessee Board of Regents
East Tennessee State University

For the Year Ended
June 30, 2004

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Director

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

February 8, 2005

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0734

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2004. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/sds
04/095

State of Tennessee

Audit Highlights

Comptroller of the Treasury　　Division of State Audit

Financial and Compliance Audit
East Tennessee State University
For the Year Ended June 30, 2004

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2004

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Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2004

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

East Tennessee State University was established by an act of the General Assembly in 1909 as East Tennessee State Normal School. In 1924, the name was changed to East Tennessee State Teachers College; in 1930, to State Teachers College, Johnson City; and in 1943, to East Tennessee State College. In 1963, by an act of the General Assembly, East Tennessee College was granted university status, and its name was changed to East Tennessee State University.

The university has nine colleges and schools: the College of Arts and Sciences, the College of Business, the College of Education, the College of Public and the Allied Health, the School of Graduate Studies, the School of Continuing Studies, the College of Medicine, the College of Applied Science and Technology, and the College of Nursing. East Tennessee State University is officially authorized to grant 14 undergraduate and 22 graduate degrees.

ORGANIZATION

The governance of East Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2003, through June 30, 2004, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2004. East Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;

3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We also obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

<u>Internal Control</u>

As part of the audit of the university's financial statements for the year ended June 30, 2004, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the university's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

October 29, 2004

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its aggregate discretely presented component units as of and for the year ended June 30, 2004, and have issued our report thereon dated October 29, 2004. We did not audit the financial statements of the East Tennessee State University Foundation and the Medical Education Assistance Corporation, discretely presented component units of the university. Those financial statements were audited by another auditor, whose reports thereon have been furnished to us. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. During the year ended June 30, 2004, the university implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.*

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the university's management in a separate letter.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/sds

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Independent Auditor's Report

October 29, 2004

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying basic financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its aggregate discretely presented component units as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audit. We did not audit the financial statements of the East Tennessee State University Foundation, which represent 67% and 22%, respectively, of the assets and revenues of the aggregate discretely presented component units of the university. We also did not audit the financial statements of the Medical Education Assistance Corporation, which represent 33% and 78%, respectively, of the assets and revenues of the aggregate discretely presented component units of the university. Those financial statements were audited by another auditor whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the East Tennessee State University Foundation and the Medical Education Assistance Corporation, is based on the reports of the other auditor.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditor provide a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of many agencies, commissions, and component units of the State of Tennessee; managing the state's debt; and making loans to the state's colleges and universities from debt proceeds. Some of the boards on which the Comptroller of the Treasury serves as a member per state statutes include the State Building Commission and the Tennessee Higher Education Commission.

In our opinion, based on our audit and the reports of the other auditor, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, East Tennessee State University, and its aggregate discretely presented component units as of June 30, 2004, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

During the year ended June 30, 2004, the university implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.*

The management's discussion and analysis on pages 9 through 21 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise East Tennessee State University's basic financial statements. The component unit cash flow statements on pages 48 through 49 presented outside of the basic financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 29, 2004, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sds

Management's Discussion and Analysis

This section of East Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2004, with comparative information presented for the fiscal year ended June 30, 2003. This discussion has been prepared by management along with the financial statements and related footnote disclosures and should be read in conjunction with them. The financial statements, notes, and this discussion are the responsibility of management.

The university has two discretely presented component units, the East Tennessee State University Foundation and the Medical Education Assistance Corporation (MEAC). More detailed information about the university's component units is presented in Note 18 to the financial statements. Information and analysis regarding the component units is also included in this section.

Using This Annual Report

This report consists of three basic financial statements. The statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows provide information on East Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The statement of net assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statements of Net Assets
(in thousands of dollars)

	ETSU		Foundation		MEAC	
	2004	**2003**	**2004**	**2003**	**2004**	**2003**
Assets:						
Current assets	$ 30,209	$ 46,428	$ 105	$ 27	$ 12,937	$ 11,758
Capital assets, net	153,738	150,913	249	822	852	960
Other assets	54,548	34,400	28,142	24,325	488	523
Total Assets	238,495	231,741	28,496	25,174	14,277	13,241
Liabilities:						
Current liabilities	19,367	17,506	54	124	3,627	3,235
Noncurrent liabilities	43,115	40,946	-	-	351	312
Total Liabilities	62,482	58,452	54	124	3,978	3,547
Net Assets:						
Invested in capital assets, net of related debt	123,518	123,106	249	822	852	960
Restricted – expendable	6,613	14,086	5,102	5,760	-	-
Restricted – nonexpendable	39	39	22,456	18,438	-	-
Unrestricted	45,843	36,058	635	30	9,447	8,734
Total Net Assets	$ 176,013	$ 173,289	$ 28,442	$ 25,050	$ 10,299	$ 9,694

Material assets consist of cash and cash equivalents; accounts, notes, and grants receivable; and capital assets. Decreases in current assets are due to an offsetting increase in investments that are classified as noncurrent. Capital assets also increased due to the capitalization of a capital gift from the ETSU Foundation of $1.3 million and construction in progress for a new student apartment complex of $3.5 million.

Material liabilities include long-term bonded debt, compensated absences, and deferred revenue. Both the current and noncurrent portion of long-term liabilities increased primarily due to additional bonds of $3.6 million for the construction of a new student apartment complex.

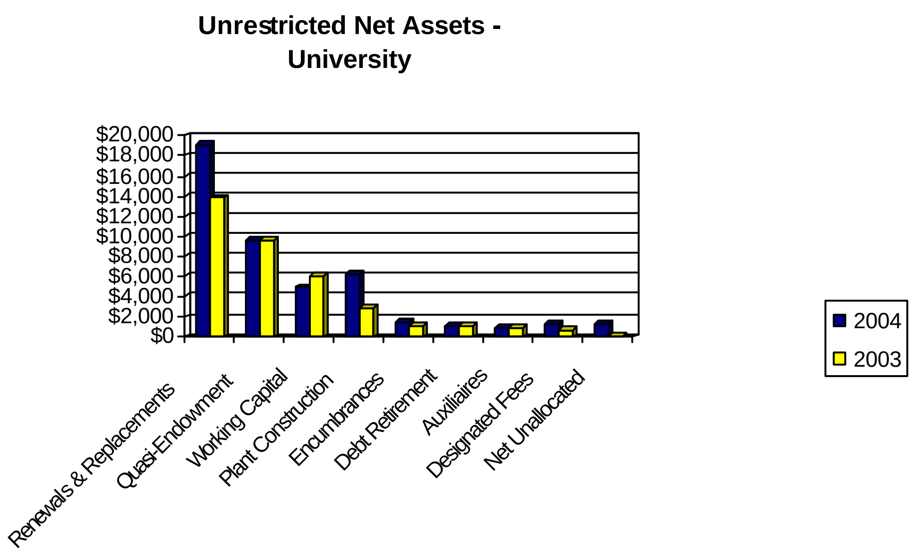
For the foundation, material assets consist of investments and cash and cash equivalents. Increases in current assets are due to increases in cash and accounts receivable. Capital assets decreased due to the transfer of the golf practice facility and building to the university in the current year. Other assets increased primarily due to increases in investments.

The only liability of the foundation is accounts payable, which substantially decreased at year end 2004.

For MEAC, material assets consist of investments, cash and cash equivalents, patient accounts receivable, and capital assets. Capital assets for MEAC decreased due to depreciation of assets.

Current liabilities for MEAC increased due to contractual expenses with Blue Cross-Blue Shield that will pay out over the next year. The increase in noncurrent liabilities is due to increases in the long-term portion of compensated absences.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, and capital projects. The following graph shows the allocations (in thousands of dollars):



The primary increase in unrestricted net assets occurred in the plant construction category. The increase is due to funds allocated for construction of the new student apartment complex and other ongoing construction projects.

The Statement of Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to accounting principles generally accepted in the United States of America.

Statements of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	ETSU		Foundation		MEAC	
	2004	**2003**	**2004**	**2003**	**2004**	**2003**
Operating revenues:						
Net tuition and fees	$41,842	$36,204	$ -	$ -	$ -	$ -
Grants and contracts	33,125	43,071	-	-	-	-
Auxiliary	8,050	7,409	-	-	-	-
Other	20,157	18,127	2,709	5,200	28,911	26,921
Total operating revenues	103,174	104,811	2,709	5,200	28,911	26,921
Operating expenses	202,350	198,587	4,805	5,904	28,435	27,237
Operating loss	(99,176)	(93,776)	(2,096)	(704)	476	(316)
Nonoperating revenues and expenses:						
State appropriations	80,403	80,791	-	-	-	-
Gifts	403	455	361	644	-	-
Investment income	1,198	1,716	3,798	(195)	122	175
Other revenues and expenses	14,583	7,055	-	(38)	7	(10)
Total nonoperating revenues and expenses	96,587	90,017	4,159	411	129	165
Income (loss) before other revenues, expenses, gains, or losses	(2,589)	(3,759)	2,063	(293)	605	(151)
Other revenues, expenses, gains, or losses:						
Capital appropriations	2,516	1,587	-	-	-	-
Capital grants and gifts	2,373	168	285	1,247	-	-
Additions to permanent endowments	-	-	1,043	2,082	-	-
Other	-	(405)	-	-	-	-
Total other revenues, expenses, gains, or losses	4,889	1,350	1,328	3,329	-	-
Increase (decrease) in net assets	2,300	(2,409)	3,391	3,036	605	(151)
Net assets at beginning of period	173,289	177,324	25,050	22,014	9,694	9,845
Prior period adjustment	424	(1,626)	-	-	-	-
Net assets at end of year	$176,013	$173,289	$28,441	$25,050	$10,299	$ 9,694

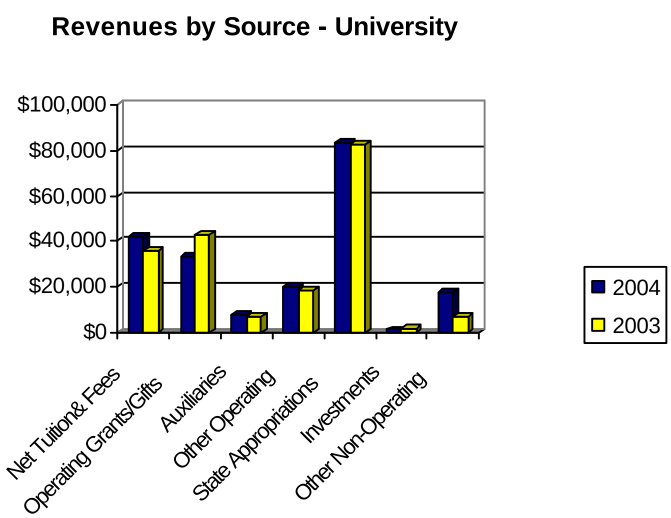
The increase in tuition and fees for the university is primarily due to a 14% increase in fees for the 2004 academic year. Operating grants and contracts decreased and other nonoperating revenues increased because Pell grants ($8,938,984) and SEOG grants ($656,347) were reclassified from operating grants and contracts to nonoperating revenue. Additionally, the university implemented a student athletic fee beginning in the 2004 academic year, generating $1.19 million in other operating revenues. Capital appropriations increased due to ongoing projects to upgrade infrastructure on campus. These projects include a steam line replacement, electrical upgrade, and capital maintenance projects. Capital grants and gifts for 2004 included gifts from the ETSU Foundation of the golf practice facility and a building valued at $1.28 million.

The reduction in operating revenues for the foundation occurred as a result of a significant decrease in in-kind gifts. This is reflected in a corresponding decrease in operating expenses. The increase in investment income is the result of significant gains in the market for investments. The large capital grant in 2003 was related to funding for the golf practice facility and building which was completed in 2004 and transferred to the university. The $2 million addition to permanent endowments for 2003 was boosted by a $1 million gift from a single donor. The donation was a one-time gift.

MEAC's other operating revenues are generated solely by patient charges. Patient charges increased due to an increase in the number of patient encounters over the prior year. The decrease in investment income correlates to the decrease in investments.

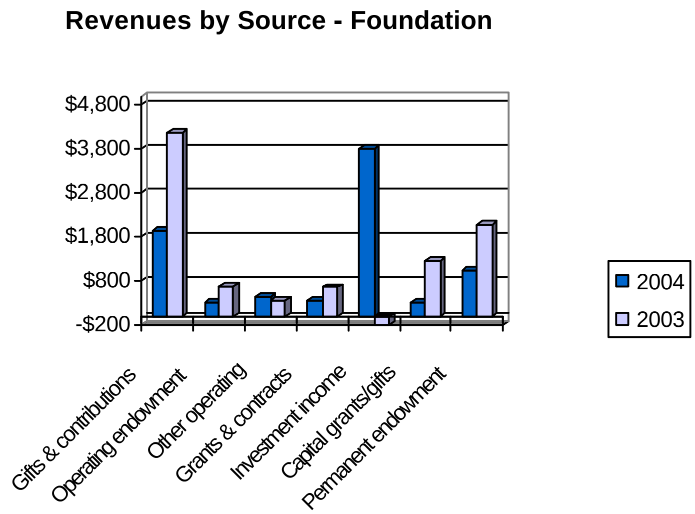
Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's operating activities for the year ended June 30, 2004, and the year ended June 30, 2003. Amounts are presented in thousands of dollars.



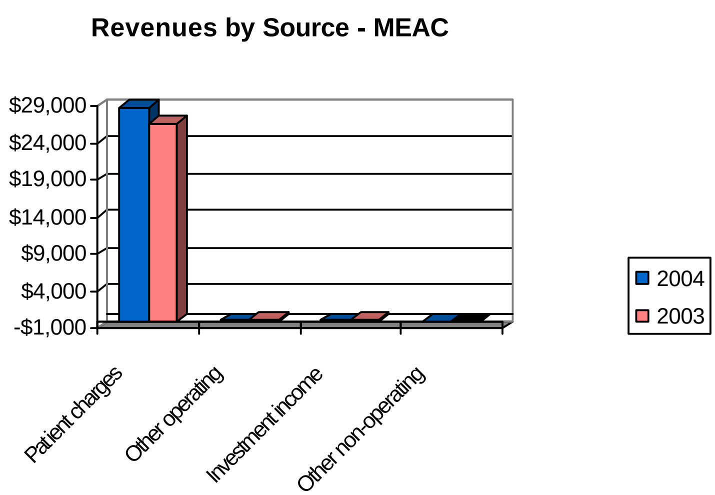
For fiscal year 2004, ETSU's revenue is primarily attributed to state appropriations, tuition and fees, and grants and contracts.

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the foundation's operating activities for the year ended June 30, 2004, and the year ended June 30, 2003. Amounts are presented in thousands of dollars.



For fiscal year 2004, the foundation's revenue is primarily attributed to investment income, and gifts and contributions.

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the MEAC's operating activities for the year ended June 30, 2004, and the year ended June 30, 2003. Amounts are presented in thousands of dollars.



For fiscal year 2004, MEAC's income is primarily attributable to patient charges.

<u>Expenses</u>

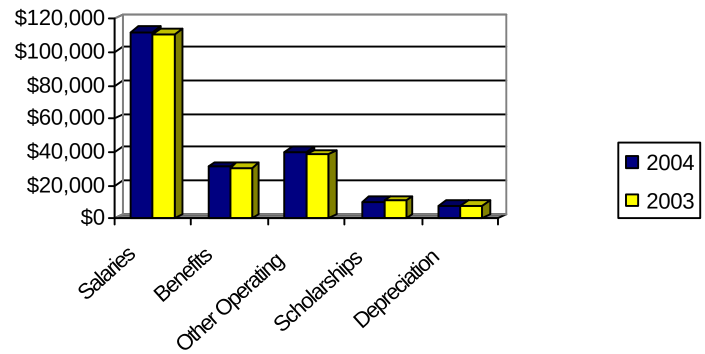
Operating expenses for the university can be displayed in two formats, natural classification and functional classification. Both formats are displayed below (in thousands of dollars).

2004 Functional Classification	2004 Natural Classification (in thousands of dollars) Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total Functional
Instruction	$67,045	$ 17,189	$ 11,677	$ 1,522	$ -	$ 97,433
Research	4,335	937	3,616	41	-	8,929
Public service	8,681	2,528	4,111	41	-	15,361
Academic support	9,568	2,766	3,050	313	-	15,697
Student services	6,607	2,154	3,490	1,403	-	13,654
Institutional support	9,538	3,164	336	124	-	13,162
Operation and maintenance of plant	5,338	2,253	9,052	1	-	16,644
Scholarships	4	6	524	7,197	-	7,731
Auxiliary	1,022	244	4,184	68	-	5,518
Depreciation	-	-	-	-	8,222	8,222
Total expenses	$ 112,138	$ 31,241	$ 40,040	$ 10,710	$ 8,222	$ 202,351

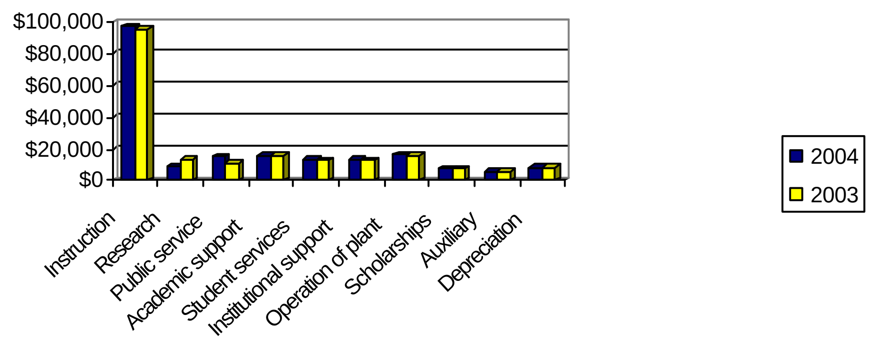
2003 Functional Classification	2003 Natural Classification (in thousands of dollars) Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total Functional
Instruction	$ 66,464	$ 16,445	$ 11,210	$ 1,536	$ -	$ 95,655
Research	6,593	2,001	4,549	45	-	13,188
Public service	6,039	1,547	3,112	42	-	10,740
Academic support	9,512	2,670	3,261	351	-	15,794
Student services	6,481	2,048	3,010	1,128	-	12,667
Institutional support	9,257	3,039	220	162	-	12,678
Operation and maintenance of plant	5,230	2,126	8,191	1	-	15,548
Scholarships	1	9	378	7,551	-	7,939
Auxiliary	1,276	287	4,541	83	-	6,187
Depreciation	-	-	-	-	8,191	8,191
Total expenses	$ 110,853	$ 30,172	$ 38,472	$ 10,899	$ 8,191	$ 198,587

For fiscal year 2004, the majority of expenses are attributed to salaries and benefits. This is depicted graphically below (in thousands of dollars).

Operating Expenses by Natural Classification - University



Operating Expenses by Functional Classification - University

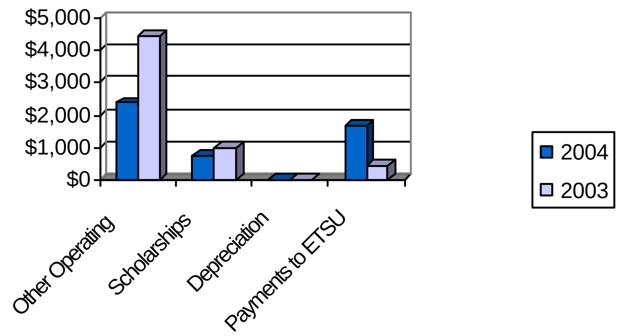


Research expenses decreased and public service expenses increased by approximately $5 million each due to a reclassification of grant accounts related to human services from research to public service. The function of the grants had changed over time and the reclassification properly reflects the change in the focus of the grants.

For fiscal year 2004, approximately one-half of operating expenses by function is attributable to instruction. The remainder is attributed to the remaining nine functional areas.

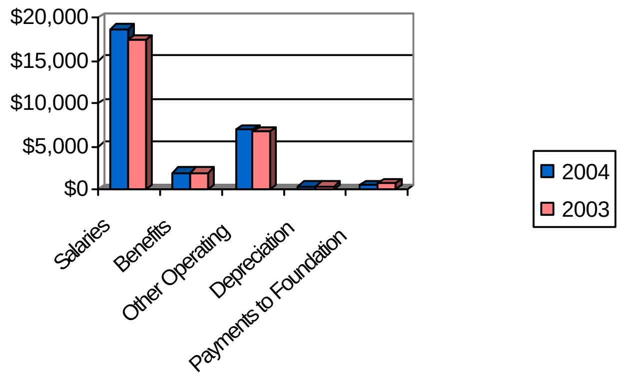
For fiscal year 2004, the majority of expenses for the foundation are attributed to operating expenses and payments to or on the behalf of ETSU. This is depicted graphically below (in thousands of dollars).

Operating Expenses by Natural Classification - Foundation



For fiscal year 2004, the majority of expenses for the MEAC are attributed to salaries and benefits and operating expenses. This is depicted graphically below (in thousands of dollars).

Operating Expenses by Natural Classification - MEAC



The Statement of Cash Flows

The statement of cash flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statements of Cash Flows
(in thousands of dollars)

	ETSU		Foundation		MEAC	
	2004	**2003**	**2004**	**2003**	**2004**	**2003**
Cash provided (used) by:						
Operating activities	$ (89,633)	$ (83,979)	$ (840)	$ (838)	$ 1,240	$ 174
Noncapital financing activities	98,193	88,016	1,404	2,727	-	-
Capital and related financing activities	(5,194)	(6,670)	(433)	681	(211)	(128)
Investing activities	(23,468)	2,118	(4,286)	(2,096)	1,259	481
Net increase (decrease) in cash	(20,102)	(515)	(4,155)	474	2,288	527
Cash, beginning of year	53,678	54,193	6,963	6,489	692	165
Cash, end of year	$ 33,576	$ 53,678	$ 2,808	$ 6,963	$ 2,980	$ 692

Material sources of cash for the university included state appropriations, tuition and fees, and grants and contracts. Material uses of cash were for payments to suppliers and vendors, payments to employees, and payments for scholarships and fellowships. Cash used by operating activities increased primarily due to reclassification of cash provided by PELL and SEOG grants to nonoperating grants and contracts and an increase in payments to suppliers. Cash provided by noncapital financing activities increased because of the reclassification of PELL and SEOG grants from operating to nonoperating grants. Cash used by capital and related financing activities decreased due to an increase in state appropriations for capital projects and proceeds from capital debt.

The cash position of the university decreased by $20,102,000 during the fiscal year ended June 30, 2004, due to moving of investments from the Local Government Investment Pool (LGIP), which is considered a cash equivalent, to investment in U.S. government securities as noted in the increase in investing activities.

Material sources of cash for the foundation included gifts and contributions, endowments, and capital grants. Material uses of cash were for payments to suppliers and vendors, payments for scholarships and purchase of capital assets. Cash provided by noncapital financing decreases primarily due to a $1 million decrease in endowment gifts and a reduction in gifts from MEAC. The decrease in cash provided by capital financing activities is a result of a one-time gift in 2003 for the golf practice facility and building. The cash used for investing activities reflects the substantial increase in foundation investments. The cash position of the foundation decreased $4,155,000 during the fiscal year ended June 30, 2004.

Material sources of cash for MEAC are patient charges and proceeds from the sale of investments. Material uses of cash are payments to employees and payments to suppliers. Cash provided by operating activities increased primarily due to an increase in patient charges which was driven by an increase in patient encounters. Cash used by capital financing activities was related to the purchase of capital assets. Cash provided by investing activities increased due to an increase in proceeds from sales and maturities of investments. The cash position of MEAC increased $2,288,000 during the fiscal year ended June 30, 2004.

Capital Asset and Debt Administration

Capital Assets

At June 30, 2004, East Tennessee State University had $153.7 million invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $8.2 million for the current fiscal year. Details of these assets are shown below. The increase in land improvements and infrastructure results from the capitalization of improvements to campus chillers and fire and energy management systems, as well as the capitalization of the foundation gift of the golf practice facility. The increase in projects in progress represents the ongoing construction of a new student apartment complex and other capital projects. All remaining depreciable categories decreased due to the recording of depreciation with no significant additions to capital assets.

Schedules of Capital Assets, Net of Depreciation
(in thousands of dollars)

	ETSU		Foundation		MEAC	
	2004	2003	2004	2003	2004	2003
Land	$ 23,517	$ 23,486	$ 225	$ 229	$ 48	$ 48
Land improvements & Infrastructure	11,200	10,142	-	-	-	-
Buildings	98,050	101,229	15	18	284	322
Equipment	6,997	7,082	9	9	520	590
Library holdings	7,452	7,882	-	-	-	-
Projects in progress	6,522	1,091	-	566	-	-
Total	$ 153,738	$ 150,912	$ 249	$ 822	$ 852	$ 960

The ETSU Foundation capital assets decreased due to the transfer of the golf practice facility and building that was under construction at June 30, 2003. The building and practice facility were transferred to the university during fiscal year 2004.

The university has planned capital expenditures to renovate the old library at a cost of $11 million and the construction of a new dormitory at a cost of $18.2 million. The library renovation is being funded by state appropriations and the construction of the dormitory is to be funded by Tennessee State School Bond Authority bonds. More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2004, the university had $30 million in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt Schedule
(in thousands of dollars)

		ETSU		
		2004		**2003**
Commercial Paper	$	333	$	-
Notes		400		450
Loans		2,162		2,261
Bonds		27,324		25,095
Total Debt	$	30,219	$	27,806

The increase in debt for the university is related to the bonds for construction of a new student apartment complex.

The Tennessee State School Bond Authority (TSSBA) must authorize all capital long-term debt on behalf of the university. TSSBA currently is rated as AA- by Standard & Poor. More detailed information about the university's long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

While the economic outlook for the State of Tennessee has improved, the university continues to lag behind the Tennessee Higher Education Commission funding formula recommendations. Following a permanent base reduction in state appropriations of 9%, which amounted to $7,480,400 for FY 2003-04, the university received level funding for FY 04-05 plus an amount sufficient to fund 1% of a required 3% across the board pay increase to all employees. The university was required to fund the remaining 2% from increased student fees. As a result of the above, the Tennessee Board of Regents authorized a 7% fee increase for FY 04-05.

The College of Medicine at East Tennessee State University has enjoyed an excellent relationship with the James H. Quillen Veterans Affairs Medical Center (VA). This strong working relationship ultimately resulted in the establishment of an "Enhanced Use Lease Agreement" in 1998 between the VA and ETSU, which allowed the medical school the long-term use of several buildings on the VA campus over a 35-year period in exchange for the College of Medicine paying the maintenance and upkeep of these buildings. The relationship has been mutually beneficial to both parties as well as the veterans and the general population of the area. Last fall, the VA, through its national "VA CARES" program, began divesting itself of buildings and properties at VA facilities across the country that were no longer directly needed for VA Purposes. The VA, together with ETSU, began the process of transferring buildings under lease plus certain additional facilities to the State of Tennessee. Currently federal legislation is being drafted to transfer over 70 acres of land and buildings with an estimated value in excess of $100 million. The university is working with appropriate state officials in this process. Should the transfer be approved, the university has agreed to absorb all maintenance and operations costs for the additional facilities not currently under lease from the VA for the foreseeable future.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the financial position or results of operations during this fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the university's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional information should be directed to Dr. David Collins, Vice President for Business and Finance, P. O. Box 70601, Johnson City, TN 37614.

Exhibit A

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF NET ASSETS
June 30, 2004

	East Tennessee State University	Component Units: East Tennessee State University Foundation	Component Units: Medical Education Assistance Corporation
ASSETS			
Current assets:			
Cash and cash equivalents (Notes 2 and 3)	$ 12,617,653.27	$ 46,351.00	$ 2,980,071.00
Short-term investments (Notes 3 and 4)	2,010,000.00	-	7,100,000.00
Accounts, notes, and grants receivable (net) (Note 5)	14,278,885.29	58,187.00	2,752,914.00
Inventories (at lower of cost or market)	542,580.42	-	-
Prepaid expenses and deferred charges	342,935.94	-	103,583.00
Accrued interest receivable	405,565.66	-	-
Other assets	12,131.70	-	-
Total current assets	30,209,752.28	104,538.00	12,936,568.00
Noncurrent assets:			
Cash and cash equivalents (Notes 2 and 3)	20,957,458.63	2,761,504.00	-
Investments (Note 4)	24,828,962.50	25,056,790.00	-
Accounts, notes, and grants receivable (net) (Note 5)	8,761,382.22	183,234.00	488,835.00
Capital assets (net) (Note 6)	153,737,807.97	249,236.00	851,780.00
Other assets	-	141,126.00	-
Total noncurrent assets	208,285,611.32	28,391,890.00	1,340,615.00
Total assets	238,495,363.60	28,496,428.00	14,277,183.00
LIABILITIES			
Current liabilities:			
Accounts payable	3,447,641.36	54,522.00	437,670.00
Accrued liabilities	4,764,568.71	-	3,101,700.00
Student deposits	391,213.44	-	-
Deferred revenue	5,772,640.37	-	-
Compensated absences (Note 8)	1,073,493.75	-	87,761.00
Accrued interest payable	310,140.68	-	-
Long-term liabilities, current portion (Note 8)	1,600,160.82	-	-
Deposits held in custody for others	898,531.58	-	-
Other liabilities	1,108,375.16	-	-
Total current liabilities	19,366,765.87	54,522.00	3,627,131.00
Noncurrent liabilities:			
Compensated absences (Note 8)	7,128,628.40	-	351,049.00
Long-term liabilities (Note 8)	28,619,331.21	-	-
Due to grantors (Note 8)	7,367,103.17	-	-
Total noncurrent liabilities	43,115,062.78	-	351,049.00
Total liabilities	62,481,828.65	54,522.00	3,978,180.00
NET ASSETS			
Invested in capital assets, net of related debt	123,518,315.94	249,236.00	851,780.00
Restricted for:			
Nonexpendable:			
Scholarships and fellowships	39,199.18	16,236,688.00	-
Other	-	6,219,100.00	-
Expendable:			
Scholarships and fellowships	33,839.48	1,006,173.00	-
Research	371,575.52	4,100.00	-
Instructional department uses	144,089.73	1,903,831.00	-
Loans	1,876,941.78	-	-
Debt service	3,125,388.30	-	-
Other	1,061,170.14	2,187,734.00	-
Unrestricted (Note 9)	45,843,014.88	635,044.00	9,447,223.00
Total net assets	$ 176,013,534.95	$ 28,441,906.00	$ 10,299,003.00

The notes to the financial statements are an integral part of this statement.

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2004

		Component Units	
	East Tennessee State University	East Tennessee State University Foundation	Medical Education Assistance Corporation
REVENUES			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of $11,338,384.80 for the year ended June 30, 2004)	$ 41,842,296.14	$ -	$ -
Gifts and contributions	-	1,964,242.00	-
Endowment income (per spending plan)	-	320,373.00	-
Governmental grants and contracts	25,116,920.40	-	-
Non-governmental grants and contracts	8,008,495.40	-	-
Sales and services of educational departments	18,023,340.46	-	-
Patient charges	-	-	28,822,633.00
Auxiliary enterprises:			
Residential life (net of scholarship allowances of $122,261.16 for the year ended June 30, 2004; all residential life revenues are used as security revenue bonds; see Note 8)	5,809,560.56	-	-
Bookstore	529,144.89	-	-
Food service	384,150.49	-	-
Center for physical activities (all revenues are used as security for revenue bonds; see Note 8)	851,005.88	-	-
Other auxiliaries	476,273.48	-	-
Interest earned on loans to students	137,528.15	-	-
Other operating revenues	1,996,437.28	424,809.00	88,412.00
Total operating revenues	103,175,153.13	2,709,424.00	28,911,045.00
EXPENSES			
Operating expenses (Notes 16 and 18):			
Salaries and wages	112,138,208.33	-	18,767,069.00
Benefits	31,241,370.86	-	1,954,786.00
Utilities, supplies, and other services	40,039,533.70	2,376,709.00	7,035,070.00
Scholarships and fellowships	10,710,189.48	732,675.00	-
Depreciation expense	8,221,419.15	2,950.00	317,340.00
Payments to or on behalf of ETSU or the ETSU Foundation	-	1,693,169.00	360,620.00
Total operating expenses	202,350,721.52	4,805,503.00	28,434,885.00
Operating income (loss)	(99,175,568.39)	(2,096,079.00)	476,160.00
NONOPERATING REVENUES (EXPENSES)			
State appropriations	80,402,767.42	-	-
Gifts (university gifts include $403,500.07 from ETSU Foundation)	403,500.07	360,620.00	-
Grants and contracts	16,275,242.14	-	-
Investment income (net of investment expense of $87,641.00 for the component units)	1,197,970.12	3,798,867.00	121,681.00
Interest on capital asset-related debt	(1,437,762.23)	-	-
Bond issuance costs	(55,277.97)	-	-
Other nonoperating revenues (expenses)	(199,208.20)	-	7,108.00
Net nonoperating revenues	96,587,231.35	4,159,487.00	128,789.00
Income (loss) before other revenues, expenses, gains, or losses	(2,588,337.04)	2,063,408.00	604,949.00
Capital appropriations	2,515,566.21	-	-
Capital grants and gifts (university gifts include $1,289,669.00 from ETSU Foundation)	2,373,166.01	284,809.00	-
Additions to permanent endowments	-	1,043,519.00	-
Total other revenues	4,888,732.22	1,328,328.00	-
Increase (decrease) in net assets	2,300,395.18	3,391,736.00	604,949.00
NET ASSETS			
Net assets - beginning of year, as restated for the university (Note 17)	173,713,139.77	25,050,170.00	9,694,054.00
Net assets - end of year	$ 176,013,534.95	$ 28,441,906.00	$ 10,299,003.00

The notes to the financial statements are an integral part of this statement.

Exhibit C

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	42,407,598.58
Grants and contracts		32,260,613.22
Sales and services of educational activities		19,058,880.17
Payments to suppliers and vendors		(39,274,884.68)
Payments to employees		(112,195,139.00)
Payments for benefits		(31,616,743.78)
Payments for scholarships and fellowships		(10,717,107.99)
Loans issued to students and employees		(2,258,757.77)
Collection of loans from students and employees		2,467,304.50
Interest earned on loans to students		123,207.97
Auxiliary enterprise charges:		
Residence halls		5,742,569.78
Bookstore		515,419.17
Food services		360,252.31
Center for physical activities		851,005.88
Other auxiliaries		602,672.06
Other receipts (payments)		2,040,335.09
Net cash provided (used) by operating activities		(89,632,774.49)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations		80,304,229.90
Gifts and grants received for other than capital or endowment purposes (university gifts include $415,931.00 from ETSU Foundation)		16,678,742.21
Federal student loan receipts		35,982,594.07
Federal student loan disbursements		(35,889,561.71)
Changes in deposits held for others		8,749.33
Net cash balance implicitly financed		1,108,375.16
Net cash provided (used) by noncapital financing activities		98,193,128.96
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt		3,928,252.03
Capital appropriations		2,515,566.21
Capital grants and gifts received		955,580.04
Purchases of capital assets and construction		(9,262,654.97)
Principal paid on capital debt and leases		(1,515,470.65)
Interest paid on capital debt and leases		(1,415,995.17)
Bond issue costs paid on new debt issue		(55,277.97)
Other capital and related financing receipts (payments)		(344,435.96)
Net cash provided (used) by capital and related financing activities		(5,194,436.44)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		2,010,000.00
Income on investments		1,531,546.52
Purchases of investments		(27,010,000.00)
Net cash provided (used) by investing activities		(23,468,453.48)
Net increase (decrease) in cash and cash equivalents		(20,102,535.45)
Cash and cash equivalents - beginning of year		53,677,647.35
Cash and cash equivalents - end of year	$	33,575,111.90

Exhibit C (Cont.)

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
June 30, 2004

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(99,175,568.39)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		8,221,419.15
Change in assets and liabilities:		
Receivables, net		301,968.99
Inventories		104,656.13
Prepaid expenses and deferred charges		(23,842.00)
Other assets		344,770.54
Accounts payable		601,542.23
Accrued liabilities		(357,973.10)
Deferred revenue		198,472.26
Deposits		4,798.87
Compensated absences		(105,463.71)
Due to grantors		43,897.81
Loans to students and employees		208,546.73
Net cash used by operating activities	$	(89,632,774.49)

Non-Cash Transactions

Gifts of capital assets	$	1,417,585.97

The notes to the financial statements are an integral part of this statement.

Tennessee Board of Regents
East Tennessee State University
Notes to the Financial Statements
June 30, 2004

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities* and in May 2002 by GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.* The financial statement presentation required by those statements provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows including its component units.

Basis of Accounting

For financial statement purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; and (5) nonoperating gifts and grants.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the restricted resources first.

Inventories

Inventories are valued at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

Capital assets, which include property, plant, equipment, and library holdings, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

A capitalization threshold of $100,000 is used for buildings, and $50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is $5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at $50,000.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

Invested in capital assets, net of related debt – This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Nonexpendable restricted net assets – Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

Expendable restricted net assets – Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets – Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2004, cash and cash equivalents consisted of $25,148.02 in bank accounts, $30,000.00 of petty cash on hand, $27,733,933.35 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $195,030.53 in LGIP deposits for capital projects, $106,000.00 on deposit with the State Treasurer, and $5,485,000.00 in overnight repurchase agreements.

LGIP deposits for capital projects - Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. DEPOSITS

The university's deposits are in financial institutions that participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. In addition, the university has one account which is entirely covered by FDIC (Federal Deposit Insurance Corporation) insurance.

At June 30, 2004, the carrying amount of the university's deposits was \$12,035,148.02, and the bank balance including accrued interest was \$13,576,768.80. The bank balance was insured.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool. The pledge level is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

The university also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 4. INVESTMENTS

The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified.

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase. Certificates of deposit have been included with other deposits in Note 3 to determine the adequacy of collateral security pledged.

The university's investments are categorized below to indicate the level of risk assumed by the university at year-end. Category 1 consists of insured or registered investments or investments for which the securities are held by the university or its agent in the university's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the university's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the university's name.

	June 30, 2004
Category 1:	
Repurchase agreements	$5,485,000.00
Category 3:	
U.S. government securities	14,828,962.50
Certificates of deposit classified as investments	12,010,000.00
Amount classified as cash equivalents	(5,485,000.00)
Total	$26,838,962.50

The university's investments in overnight repurchase agreements at June 30, 2004, are reported as category 1. These amounts are insured via the bank collateral pool administered by the State Treasurer.

NOTE 5. RECEIVABLES

Receivables included the following:

	June 30, 2004
Student accounts receivable	$4,657,785.39
Grants receivable	8,349,588.96
Notes receivable	482,371.33
State appropriation receivable	230,000.00
Other receivables	3,138,491.91
Subtotal	16,858,237.59
Less allowance for doubtful accounts	1,635,690.48
Subtotal	$15,222,547.11

Federal Perkins Loan Program funds included the following:

Perkins loans receivable	9,020,490.84
Less allowance for doubtful accounts	1,202,770.44
Subtotal	$ 7,817,720.40
Total receivables	$23,040,267.51

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$23,486,301.74	$ -	$30,200.00	$ -	$23,516,501.74
Buildings	174,400,929.14	937,252.40	49,837.76	-	175,388,019.30
Land improvements and infrastructure	15,485,586.75	554,083.21	1,320,273.29	-	17,359,943.25
Equipment	24,974,507.54	1,613,327.17	-	563,412.69	26,024,422.02
Library holdings	16,047,212.49	1,305,314.08	-	1,558,068.85	15,794,457.72
Projects in progress	1,091,043.45	6,831,084.77	(1,400,311.05)	-	6,521,817.17
Total	255,485,581.11	11,241,061.63	-	2,121,481.54	264,605,161.20

Less accum. depreciation:					
Buildings	73,172,260.51	4,165,763.22	-	(.14)	77,338,023.87
Land improvements and infrastructure	5,343,546.58	816,128.80	-	-	6,159,675.38
Equipment	17,892,101.26	1,504,274.46	-	368,808.33	19,027,567.39
Library holdings	8,164,902.77	1,735,252.67	-	1,558,068.85	8,342,086.59
Total accum. depreciation	104,572,811.12	8,221,419.15	-	1,926,877.04	110,867,353.23
Capital assets, net	$150,912,769.99	$3,019,642.48	$ -	$ 194,604.50	$153,737,807.97

NOTE 7. CAPITAL LEASES

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veteran's Affairs for certain real property and buildings at the Veteran's Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veteran's Affairs to construct a new building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided $18 million to the federal government for its share of the total construction costs ($34,195,153.41). The Basic Science Building is included under the provisions of the Enhanced Use Lease Agreement.

The university's leasing of the Basic Science Building will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the building at $34,195,153.41. At June 30, 2004, the building is reported at $30,989,357.79, net of accumulated depreciation of $3,205,795.62.

NOTE 8. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Notes	$ 450,000.00	$ -	$ 50,000.00	$ 400,000.00	$ 50,000.00
Loans	2,261,479.36	-	99,223.94	2,162,255.42	106,318.45
Bonds	25,095,231.29	3,594,832.35	1,366,246.71	27,323,816.93	1,443,842.37
Commercial paper	-	333,419.68	-	333,419.68	-
Subtotal	27,806,710.65	3,928,252.03	1,515,470.65	30,219,492.03	1,600,160.82
Other liabilities:					
Compensated absences	8,307,585.86	4,552,833.18	4,658,296.89	8,202,122.15	1,073,493.75
Due to grantors	7,323,205.36	43,897.81	-	7,367,103.17	-
Subtotal	15,630,791.22	4,596,730.99	4,658,296.89	15,569,225.32	1,073,493.75
Total long-term liabilities	$43,437,501.87	$8,524,983.02	$6,173,767.54	$45,788,717.35	$2,673,654.57

Notes Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for renovation of the Memorial Athletic Medical Center ("BucSports"). The note bears an annually adjusted interest rate equal to the average Local Government Investment Pool rate for the previous year, a face amount of $500,000.00, a minimum annual debt service of $50,000.00 plus interest, with payments due annually to 2012. The balance owed by the university was $400,000.00 at June 30, 2004.

Debt service requirements to maturity for notes payable at June 30, 2004, are as follows:

Year Ending June 30	Principal	Interest	Total
2005	$ 50,000.00	$ 4,200.00	$ 54,200.00
2006	50,000.00	3,675.00	53,675.00
2007	50,000.00	3,150.00	53,150.00
2008	50,000.00	2,625.00	52,625.00
2009	50,000.00	2,100.00	52,100.00

2010 – 2012	150,000.00	3,150.00	153,150.00
	$400,000.00	$18,900.00	$418,900.00

Loans Payable

The Tennessee General Assembly earmarked in Section 41, Item 41 of Chapter 563 of the Public Acts of 1989 the amount of $3,000,000 from the funds appropriated in Section 1, Title 111-25 of Chapter 563 of the Public Acts of 1989 for the East Tennessee State University Clinical Education Facility. These funds were intended to be an interest-bearing loan from the General Fund to the Tennessee Board of Regents on behalf of East Tennessee State University. The loan bears an interest rate of 7.15%, has a principal amount of $3,000,000.00, a minimum annual debt service of $260,919.72 and a due date of January 1, 2017. The balance owed as of June 30, 2004, was $2,162,255.42.

Debt service requirements to maturity for all loans payable at June 30, 2004, are as follows:

Year Ending June 30	Principal	Interest	Total
2005	$106,318.45	$154,601.27	$260,919.72
2006	113,920.22	146,999.50	260,919.72
2007	122,065.51	138,854.21	260,919.72
2008	130,793.20	130,126.53	260,919.73
2009	140,144.91	120,774.82	260,919.73
2010 – 2014	866,149.72	438,448.92	1,304,598.64
2015 – 2017	682,863.41	99,895.59	782,759.00
	$2,162,255.42	$1,229,700.84	$3,391,956.26

Bonds Payable

Bond issues, with interest rates ranging from 3.0% to 5.5% for Tennessee State School Bond Authority bonds, are due serially to 2034 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $76,933.55 at June 30, 2004. Unexpended debt proceeds were $783,416.88 at June 30, 2004.

Debt service requirements to maturity for bonds payable at June 30, 2004, are as follows:

Year Ending June 30	Principal	Interest	Total
2005	$1,443,842.37	$1,380,050.05	$2,823,892.42
2006	991,104.68	1,295,798.08	2,286,902.76
2007	982,254.45	1,252,259.23	2,234,513.68
2008	1,025,538.60	1,210,510.97	2,236,049.57
2009	1,072,296.83	1,165,792.72	2,238,089.55
2010-2014	5,190,016.78	5,089,142.21	10,279,158.99
2015-2019	4,942,435.54	3,844,210.26	8,786,645.80
2020-2024	5,167,319.90	2,561,395.33	7,728,715.23
2025-2029	3,958,569.17	1,456,537.08	5,415,106.25
2030-2034	2,550,438.61	398,030.12	2,948,468.73
	$27,323,816.93	$19,653,726.05	$46,977,542.98

Commercial paper

The Tennessee State School Bond Authority authorized the issuance of Commercial Paper to finance the costs of various capital projects. The amount issued for projects at the university was $333,419.68 at June 30, 2004.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

NOTE 9. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. The unrestricted net assets are composed of the following:

	June 30, 2004
Working capital	$4,962,245.61
Encumbrances	1,506,192.01
Designated fees	1,338,536.44
Auxiliaries	857,815.50
Quasi-endowment	9,663,307.54
Plant construction	6,221,700.95
Renewal and replacement of equipment	19,062,455.63
Debt retirement	1,111,967.27
Unreserved/undesignated	1,118,793.93
Total	$45,843,014.88

NOTE 10. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to spend net appreciation, the university is required to consider the university's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation spent is required to be spent for the purposes for which the endowment was established.

The university's endowment and quasi-endowment assets are invested to produce only interest income. For the fiscal year ended June 30, 2004, the university's endowments and quasi-endowments earned interest income totaling $85,960.73. The university retained $25,090.78 for expenditure in future years, of which $46.06 is restricted to specific purposes.

NOTE 11. PENSION PLANS

A. Defined Benefit Plans

1. Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 7.3% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2004, 2003, and 2002 were $2,414,168.28, $2,372,506.81, and $1,904,373.30. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the

TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated.* State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $5,912,048.14 for the year ended June 30, 2004, and $5,872,612.05 for the year ended June 30, 2003. Contributions met the requirements for each year.

NOTE 12. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 13. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of casualty losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The Risk Management Fund is also responsible for claims for damages to state owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from

$25,000 per occurrence, depending on the type of coverage, to an aggregate of $7.5 million.

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2004, the Risk Management Fund held $101.1 million in cash designated for payment of claims.

During the year ended June 30, 2003, the state incurred 13 property claims which exceeded the per occurrence deductible. The gross amount of claims for the period was approximately $7.2 million, of which the state's property insurance carrier will ultimately assume approximately $2.2 million.

At June 30, 2004, the scheduled coverage for the university was $429,950,000 for buildings and $100,598,043 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 14. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $41,019,508.32 at June 30, 2004.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $187,018.31 and for personal property were $138,289.83 for the year ended June 30, 2004. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2004, outstanding commitments under construction contracts totaled $1,487,336.95 for the Steam Line Emergency Replacement, College of Medicine Roofing, Accessibility Adaptations, Fossil Site Visitor Center, Forensic Pathology Renovations, and Fire Alarm Systems projects, of which $769,969.95 will be funded by future state capital outlay appropriations.

Litigation - The university is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 15. CHAIRS OF EXCELLENCE

The university had $19,327,047.91 on deposit at June 30, 2004, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 16. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2004, are as follows:

Natural Classification

Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$67,044,582.71	$17,189,729.00	$11,677,012.54	$1,521,882.09	$ -	$97,433,206.34
Research	4,334,669.59	936,964.51	3,616,612.23	41,139.26	-	8,929,385.59
Public service	8,680,524.28	2,528,571.93	4,110,953.34	41,037.23	-	15,361,086.78
Academic support	9,568,486.41	2,765,808.45	3,049,379.88	312,751.58	-	15,696,426.32
Student services	6,606,734.58	2,153,695.47	3,489,783.46	1,403,337.12	-	13,653,550.63
Institutional support	9,537,988.26	3,164,470.82	335,954.01	123,925.48	-	13,162,338.57
Operation & maintenance of plant	5,338,465.40	2,252,001.19	9,052,159.04	1,507.15	-	16,644,132.78
Scholarships & fellowships	4,476.00	6,155.47	523,397.28	7,197,059.03	-	7,731,087.78
Auxiliary	1,022,281.10	243,974.02	4,184,281.92	67,550.54	-	5,518,087.58
Depreciation	-	-	-	-	8,221,419.15	8,221,419.15
Total	$112,138,208.33	$31,241,370.86	$40,039,533.70	$10,710,189.48	$8,221,419.15	$202,350,721.52

NOTE 17. PRIOR-YEAR RESTATEMENT

The university failed to capitalize $423,786.00 of capital assets (infrastructure) at June 30, 2003. As a result, for the year ended June 30, 2004, the beginning balance of net assets – invested in capital assets, net of related debt, has been increased by $423,786.00.

NOTE 18. COMPONENT UNITS

East Tennessee State University Foundation

The East Tennessee State University Foundation is a legally separate, tax-exempt organization supporting East Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 30-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

Complete financial statements for East Tennessee State University Foundation can be obtained from Dr. David Collins, Vice President for Business and Finance, ETSU, P.O. Box 70601, Johnson City, TN 37614.

During the year ended June 30, 2004, the foundation made distributions of $1,693,169.00 to or on behalf of the university for both restricted and unrestricted purposes.

<u>Cash and cash equivalents</u> – In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2004, cash and cash equivalents consisted of $196,219 in bank accounts, $370 of petty cash on hand, $1,573,425 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $1,037,841 in money market mutual funds held by stockbrokers.

<u>Deposits</u> – Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the foundation. Category 1 consists of deposits that are insured or collateralized with securities held by the foundation or by its agent in the foundation's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the foundation's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the foundation's name.

At June 30, 2004, the carrying amount of the foundation's deposits was $196,219, and the bank balance including accrued interest was $92,306. The entire bank balance was category 1.

The foundation also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

Investments – The foundation is authorized to invest funds in accordance with its board of directors' policies. All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

The foundation's investments are categorized below to indicate the level of risk assumed by the foundation at year-end. Category 1 consists of insured or registered investments or investments for which the securities are held by the foundation or its agent in the foundation's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the foundation's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the foundation's name.

	June 30, 2004
Category 1:	
Corporate stocks	$14,927,788
Category 2:	
Corporate stocks	5,129,553
Category 3:	
U.S. government securities	4,999,449
Total	$25,056,790

Pledges Receivable – Pledges receivable are summarized below net of the allowance for doubtful accounts.

	June 30, 2004
Current pledges	$77,484
Pledges due in one to five years	111,704
Pledges due after five years	2,155
Subtotal	191,343
Less discounts to net present value	7,728
Total pledges receivable, net	$183,615

Capital assets – Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$228,500	$ -	$ -	$ 3,500	$225,000
Buildings	59,000	-	-	-	59,000
Equipment	9,486	-	-	-	9,486
Projects in progress	565,821	718,504	-	1,284,325	-
Total	862,807	718,504	-	1,287,825	293,486
Less accumulated depreciation	41,300	2,950	-	-	44,250
Capital assets, net	$821,507	$715,554	$ -	$1,287,825	$249,236

Medical Education Assistance Corporation

The Medical Education Assistance Corporation (MEAC) is a legally separate, tax-exempt organization supporting East Tennessee State University. MEAC acts primarily as a physicians' practice group to supplement the resources that are available to the university in support of its medical programs. The 15-member board of MEAC is self-perpetuating and consists of the department chairs from Quillen College of Medicine, a representative from East Tennessee State University's Business and Finance Department, a representative from the Tennessee Board of Regents, and at-large faculty from the Quillen College of Medicine. Although the university does not control the timing or amount of receipts from MEAC, the residual income that MEAC earns is restricted to supporting medical education. Because these restricted resources held by MEAC can only be used by, or for the benefit of, the university, MEAC is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2004, MEAC made distributions of $360,620 to East Tennessee State University Foundation. Complete financial statements for MEAC can be obtained from Russell Lewis, Executive Director, P. O. Box 699, Mountain Home, Tennessee 37684.

Cash – This classification includes demand deposits and petty cash on hand. At June 30, 2004, cash consisted of $2,711,911 in bank accounts, $2,215 of petty cash on hand, and $265,945 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

Deposits – Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the corporation. Category 1 consists of deposits that are insured or collateralized with securities held by the corporation or by its agent in the corporation's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the corporation's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the corporation's name.

At June 30, 2004, the carrying amount of the corporation's deposits was $9,811,911, and the bank balance including accrued interest was $10,325,939. The entire bank balance was category 2. Certificates of deposit have been included with other deposits to determine the adequacy of collateral security pledged.

The corporation also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

Investments – The corporation is authorized to invest funds in accordance with its board of directors' policies. The corporation's investments at June 30, 2004, consisted of certificates of deposit with original maturities greater than three months. These have been included with other deposits to determine the adequacy of collateral security pledged.

Capital assets – Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 48,328	$ -	$ -	$ -	$ 48,328
Buildings	286,682	13,390	-	-	300,072
Leasehold improvements	385,451	-	-	-	385,451
Equipment	3,089,613	195,862	-	18,756	3,266,719
Total	3,810,074	209,252	-	18,756	4,000,570
Less accumulated depreciation:					
Buildings	52,773	13,027	-	-	65,800
Leasehold improvements	297,683	38,052	-	-	335,735
Equipment	2,499,748	266,261	-	18,754	2,747,255
Total accumulated depreciation	2,850,204	317,340	-	18,754	3,148,790
Capital assets, net	$ 959,870	($108,088)	$ -	$ 2	$ 851,780

Long-term liabilities – Long-term liabilities activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$389,692	$49,118	$ -	$438,810	$87,761

NOTE 19. AFFILIATED ENTITY NOT INCLUDED

The East Tennessee State University Research Foundation was incorporated on July 10, 2002, as a nonprofit corporation with the university as the sole beneficiary. The first activity for the Research Foundation occurred in November 2002. The corporation is controlled by a board independent of the institution. As reported on the most recently prepared unaudited financial reports, at June 30, 2004, the assets of the Research Foundation totaled $100,499.25, liabilities were $4,000.05 and the net assets amounted to $96,499.20.

SUPPLEMENTARY INFORMATION
EAST TENNESSEE STATE UNIVERSITY FOUNDATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	1,740,971.00
Endowment income per spending plan		320,373.00
Payments to suppliers and vendors		(2,158,148.00)
Payments for scholarships and fellowships		(751,904.00)
Payments to East Tennessee State University		(415,931.00)
Other receipts (payments)		424,809.00
Net cash provided (used) by operating activities		(839,830.00)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Gifts and grants received for other than capital or endowment purposes		360,620.00
Private gifts for endowment purposes		1,043,519.00
Other noncapital financing receipts (payments)		100.00
Net cash provided (used) by noncapital financing activities		1,404,239.00
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital grants and gifts received		284,809.00
Purchases of capital assets and construction		(718,504.00)
Net cash provided (used) by capital and related financing activities		(433,695.00)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		4,577,351.00
Income on investments		869,046.00
Purchases of investments		(9,732,573.00)
Net cash provided (used) by investing activities		(4,286,176.00)
Net increase (decrease) in cash and cash equivalents		(4,155,462.00)
Cash and cash equivalents - beginning of year		6,963,317.00
Cash and cash equivalents - end of year	$	2,807,855.00
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(2,096,079.00)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		2,950.00
Other adjustments		1,289,669.00
Change in assets and liabilities:		
Receivables, net		33,676.00
Accounts payable		(70,046.00)
Net cash used by operating activities	$	(839,830.00)
Non-Cash Transactions		
Gifts in-kind	$	232,168.00
Unrealized gains/losses on investments	$	2,873,165.00
Loss on disposal of capital assets	$	1,289,669.00

SUPPLEMENTARY INFORMATION
MEDICAL EDUCATION ASSISTANCE CORPORATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Collections from patient charges	$	27,625,337.00
Payments to suppliers and vendors		(5,444,515.00)
Payments to employees		(18,736,515.00)
Payments for benefits		(1,954,786.00)
Payments to East Tennessee State University		(360,620.00)
Other receipts (payments)		110,998.00
Net cash provided (used) by operating activities		1,239,899.00
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets		275.00
Purchases of capital assets and construction		(209,252.00)
Interest paid on capital debt and leases		(2,166.00)
Net cash provided (used) by capital and related financing activities		(211,143.00)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		202,406.00
Income on investments		121,681.00
Purchases of investments		(7,100,000.00)
Other investing receipts (payments)		34,817.00
Net cash provided (used) by investing activities		(6,741,096.00)
Net increase (decrease) in cash and cash equivalents		(5,712,340.00)
Cash and cash equivalents - beginning of year		8,692,411.00
Cash and cash equivalents - end of year	$	2,980,071.00
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	476,160.00
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense		317,340.00
Other adjustments		9,000.00
Change in assets and liabilities:		
Receivables, net		(100,406.00)
Prepaid expenses and deferred charges		106,986.00
Accounts payable		88,013.00
Accrued compensation		30,554.00
Other		312,252.00
Net cash provided by operating activities	$	1,239,899.00
Non-Cash Transactions		
Loss on disposal of capital assets	$	18,755.00